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Nos. 73-437, 73-457, 73-464

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

MOBIL OIL CORPORATION, *et al.*,
Petitioners,

v.

FEDERAL POWER COMMISSION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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REPLY BRIEF FOR PETITIONER MOBIL OIL CORPORATION

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REPLY BRIEF FOR PETITIONER MOBIL OIL CORPORATION

Petitioner Mobil Oil Corporation (Mobil) hereby replies to the five briefs filed on time by Respondents other than the Federal Power Commission. In order not to delay consideration of this case, Mobil replies to the five timely briefs and, if necessary, will seek leave to file a supplemental reply to the brief filed late on behalf of the Federal Power Commission.*

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* Draft copies of the Brief for the Federal Power Commission were not received by Counsel for Mobil until April 9, 1974. The delay thus has precluded review, preparation of responses, printing, and filing of a timely reply thereto under the Rules.

ARGUMENT

I. "Settlement" Procedures Do Not Erase the Standards of the Natural Gas Act, or Supply Missing, but Required, Findings of Fact Based Upon Substantial Evidence

Respondents seek to cover the illegalities of the rate structure and the fatal gaps in Commission Opinion No. 598 by enumerating the size of their chorus and by repeating the dinning refrain that the opposed "settlement" was supported by "substantial evidence." The fatal flaws, however, remain:

1. No one has suggested that the Commission is barred from considering an opposed "settlement." Of course, it may. However, when the Commission does so, the Commission still is required to accord due process to opponents. If it adopts the brokered result of off-the-record bargaining in a rate case, the Commission also must issue a decision which, in particulars and in result, complies with (1) the requirements of the Natural Gas Act for *express* findings of fact upon substantial evidence *and* (2) the substantive standards of Section 4 and 5 of the Act. In this case, the Commission did not do so.

Here, the "settlement" proposal was made a part of the record by Commission order and without sponsoring witnesses available for cross-examination (I.A. 352-354). Respondents now argue that the detailed substance of that proposal was supported by various parts of the record. However, the Commission opinions contain no *findings* or conclusions as to the evidence, *pro* or *con*, on major, critical elements of the proposal to dispose of more than $375,000,000 in refund liabilities and to prescribed *annual* charges of more than $1,235,000,000 in an area supplying one-third of the nation's interstate natural gas supply.

Post-hoc rationalizations cannot fill the gaps; and, as shown *infra*, even *if* the Commission had made findings and conclusions on disputed, material facts, the brokered result still was not supported by the record. Yet, the Commission's duties under the Act cannot be so avoided by reference to the number of brokers or by giving way to dictates by the brokers that the Commission "must" accept their result "as a whole" and may not consider it "piecemeal" (See I A. 116, IV A. 698, IV A. 788-789).

The Commission opinions show that the Commission did, in fact, accede to such demands without critical appraisal of the rate structure, without findings and conclusions required by the statute, and without modifying the proposal where parts patently conflict with the substantive standards of Sections 4 and 5 of the Act. Thus, the Commission meticulously modified even minutiae in its first opinion to conform to every letter of the proposal (II A. 865-885); rejected required "new gas" rates because of the "refund" package (II A. 870); and turned its back on those who had followed its past guidelines and policies *solely* because of the dictates of the "settlement" proponents (II A. 600-601). Moreover, even when one of the proponents urged that only producers who actually dedicate new reserves to earn contingent escalations should receive the escalations, the Commission found this proposition "had much to commend it," but rejected the modification because it was "not part of the settlement package" (II A. 874).

What is now said here thus simply does not jibe with what actually occurred before the Commission.

2. More important, compliance with the substantive standards of the Act cannot be achieved merely by counting votes of the parties, as Respondents suggest. Specific rates still must be in accord with the "end result" test of *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944). *Each* of the "essential

elements" of the area rate order also still must be supported and lawful under the constructions in *Permian Basin Area Rate Cases*, 390 U.S. 747, 792, 813, 822 (1968); and the impact, consequences, and results still must not be unjust, unduly discriminatory, and unduly preferential, as correctly held in *Texas Gulf Coast Area Rate Cases (Public Service Commission for the State of N.Y. v. Federal Power Commission)*, 487 F.2d 1043 (D.C. Cir. 1973), a case rarely mentioned by Respondents. There, an identical rate structure and refund-forgiveness formula were held to violate the standards of Sections 4 and 5, and not simply the "substantial evidence" test (487 F.2d at 1076-1079).

Respondents thus err in asserting that issues raised by Petitioners do not go to the "substance" of the rate structure (see UDC Br., p. 13; Exxon, *et al.*, Br., p. 15), and in stating that no one urges that the Commission decision "viewed in its entirety" is "unreasonable" in its consequences (UDC Br., p. 34). To the contrary, major components of the supposedly inviolate "settlement package" *are* unsupported and unlawful; and the result, both in design and in consequences, *is* unjust, unreasonable, unduly discriminatory, and unduly preferential.

The origin of this "package" therefore required more, not less meticulous Commission scrutiny. The origin of the "package" also could not erase the requirements of Sections 4 and 5, of *Hope*, and of *Permian*. The proposed treatment of refunds and related rate structure required the critical analysis accorded by the District of Columbia Circuit in the *Texas Gulf Coast* case. So tested, the rate structure cannot pass statutory tests, and not even hosts of proponents can hide the substantive illegalities. As in *Texas Gulf Coast*, components of the rate structure are unlawful and can be corrected only by Commission modification of Opinion No. 598. As in *Texas Gulf Coast*, an illegal rate structure affecting not only

the past, but also the future, should not be left standing merely because of the argument of "delay" (*Cf.* California Co. Br., p. 14; AGD Br., p. 10).

II. Treatment of Refunds Violates Standards of Sections 4 and 5 of the Act

The impact and consequences of treatment of refunds, in relation to other components of the area rate structure, are avoided by Respondents. Yet, neither a "settlement" nor alleged "substantial evidence" can remove the requirement that the *results* be measured against Sections 4 and 5:

1. Respondents assert that Mobil's objections arise "solely" because Mobil followed Commission guidelines and policies in the past and "voluntarily" settled refund liabilities (*e.g.*, California Co. Br., pp. 17, 22-24, Exxon, *et al.*, Br., pp. 38-39; UDC Br., pp. 11, 15, 34-36). This, of course, is not so.

The policies and procedures adhered to by Mobil were available to *all* producers and were applied by the Commission to do equity and to *remove* discrimination.[1] They also were available for application in this case. Instead, to accommodate the demands of those who owe the bulk of the refunds because of *past* collections in excess of just and reasonable rates, all of the components of the *present* and *future* rate structure for this critical area for most of the 1970's were sacrificed.

Mobil obviously would have no objection to disposition of refund liabilities of other producers in accordance with established Commission policies and precedent. However, that is *not* what is sought here:

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[1] See composite refund percentages applied by the Commission in *Jack W. Grigsby*, 32 FPC 529 (1964); and the rate structure tailormade to *remove* discrimination discussed in *Hugoton-Anadarko Area Rate Case: California* v. *Federal Power Commission*, 466 F.2d 974 (9th Cir. 1972).

(1) Working capital far in excess of that otherwise available is selectively permitted for a few producers for present and future use *without* comparable allowances to other producers who followed Commission guidelines;

(2) The refund "formula" is tailored so that producers, such as Mobil, who made refunds in the past and charged lower rates actually are required to make larger refunds than producers who collected the highest rates for the period from October 1, 1968 to January 1, 1971 (see discussion in Mobil's opening Brief at pages 50-51 and Appendix A-2 to that Brief);

(3) The area rates for *present* and *future* sales of "flowing gas" are lowered *because* of the refund treatment and without findings or conclusions upon disputed cost issues, return, or revenue requirements, so that rates of Mobil and others similarly situated would be reduced because of retention of the refund amounts as additional working capital by others (see, *e.g.*, Commission statements at II A. 647-648);[2]

(4) The area rate for "new gas" for the present and future is copied from the "settlement" and pegged at that level *because* of the treatment of refunds (II A. 870); and the effect also is to allow those who owe refunds realization equal to 27 cents per Mcf for sales of "new gas" while others receive 26 cents per Mcf;

(5) The beneficiaries of the refund-forgiveness formula also will receive the benefits of future escalations of "flowing gas" rates actually earned by Mobil and others, while the beneficiaries do not contribute toward earning

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[2] For example, Respondents cannot avoid the fact that on a strict "cost" basis, the Commission's Staff recommended 22 cents per Mcf for the critical offshore area (IV A. 685). Yet, the Commission adopted the lower rate in the "settlement" without discussion or findings on the revenue requirements involved.

those escalations and use of their own new reserve dedications to discharge their individual refund liabilities.[3]

These unduly discriminatory and preferential distortions of the *present* and the *future* rate structure thus are at the heart of the "package." These results do *not* arise because of adherence by Mobil and others to Commission guidelines and policies from 1960 to 1968. These results arise because of the *present* and *future* area rate structure, affect the present and future competitive position of producers, and result in dispersion of revenues from current and future sales carefully tailored to benefit those who ignored Commission policies and guidelines.

Such inequitable, unlawful results are *not* the product of Mobil's past "voluntary" compliance, but are the product of deliberate choices by which the present and future area rates are molded solely to accommodate producers who did not follow Commission guidelines and policy. At a time when business enterprises increasingly are called upon to adhere to guidelines so announced by federal agencies, such an approach is hardly conductive to cooperation or protection of all interests affected.[4]

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[3] This feature of the "settlement" was objected to by Texaco Inc., which otherwise acquiesced in the proposal. However, the Commission declined to modify even this unfair part of the "package":

> "*Texaco* urges us to adopt a contingent escalation program predicated on individual producer dedications of gas rather than on an industry-wide basis. This is another policy alternative which, *if it were not part of the settlement package*, has much to commend it. We selected the alternative we did for the reasons stated." (II A. 874, emphasis supplied).

[4] As Mobil showed in its opening brief, the Commission has applied the same "refund forgiveness" formula in area rate decisions for the Texas Gulf Coast, Other Southwest, and Permian Basin areas. Such a formula can only engender a "devil-take-the-hindmost" race to the Commission to increase rates under Section 4. If amounts collected subject to refund in excess of rates later found just and reasonable are to be so retained for working capital and future "credits," then competitive pressures alone obviously would require

Here, the individual liabilities as to the past should not have been so mixed up with required lawful area rates for the present and future.

2. The number of supporters of such a tailored "settlement" and claims of support on "substantial evidence" do not remove the illegal impact and consequences. The ultimate *results* still run afoul of the substantive standards of Section 4 and 5 of the Act as the District of Columbia Circuit correctly held in the *Texas Gulf Coast* case.

The results are not "hypothetical" or "abstract theories," as Respondents argue (see, *e.g.*, UDC Br., pp. 35). The Court in the *Texas Gulf Coast* case correctly found the results to be very real, plain, and unlawful. These results *are* the "consequences" of the order upon "the character and future development of the industry" which the Commission is required to assess (*Permian*, 390 U.S. at 792, 822). That assessment includes inquiry into the effects upon the character of the industry, the degree of concentration, industry competition, and expected results of the rate order (*Southern Louisiana Area Rate Cases I (Austral Oil Co.* v. *Federal Power Commission)*, 428 F.2d 407, 442 (5th Cir. 1970).

Section 5(a) also requires that such unduly discriminatory effects be avoided (*Texas Gulf Coast Area Natural Gas Rate Cases*, 487 F.2d at 1074). Yet, the unduly discriminatory and anti-competitive effects are patent and fall upon "old producers" as well as upon "new entrants" (487 F.2d at 1076). These illegalities do not arise solely because of the Commission's rearrangement of the past individual liabilities incurred up to August 1, 1971. Certainly, the Commission may adopt new policies, but here the Commission has done so in a manner that penalizes compliance with past policies and guidelines *and* extends such penalties into the present and fu-

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the filing and collection of the highest possible rates under Section 4(e) at every possible opportunity.

ture. Such results violate the Act and the requirements for lawful area rate orders:

> "Generally, at least, uniform prices give all producers an equal opportunity to reduce their costs, or improve their efficiency, to maximize their returns. When a rate differential is fixed by federal regulation, without basis in costs, there is a handicap to opportunity that cannot be removed by effort of the disadvantaged producer to enhance efficiency and competitiveness. This is not merely a problem where 'one producer's piece of cake is iced and another's is not.'" (*Texas Gulf Coast Area Natural Gas Rate Cases*, 487 F.2d at 1076).

3. Respondents also suggest that unduly discriminatory and preferential results are inherent or unavoidable in the "group" or "industry" methods used in area-rate-making (*e.g.*, UDC Br., pp. 34-36, Exxon, *et al.*, Br., pp. 36-37). Such results do not follow, and the Courts consistently have rejected this notion. Lawful present and future area rates have been and can be separated from lawful, equitable disposition of past refund liabilities incurred under Section 4(e) of the Act by individual producers.

In *Permian*, this Court reviewed a similar argument as to disposition of refunds (390 U.S. at 825-828). The Tenth Circuit had reversed the Commission's refund order on grounds, such as those now asserted here, that comparisons of past aggregate costs and past aggregate revenues indicated an industry-wide revenue deficiency in the past, and that refunds by individual companies therefore should not be ordered. This Court reversed the Tenth Circuit, indicating that such a comparison is not dispositive, and that the Commission could consider "equitable contract-by-contract" disposition of the issue without reference to "group revenues" and "group revenue requirements" (390 U.S. at 828). Moreover, this Court

referred to reasonable Commission conclusions that the aggregate approach ". . . would prove both inequitable to consumers and difficult to administer." This Court also foretold arguments and adjectives now used here as to Mobil's alleged "improvidence" in following past Commission guidelines. This Court said:

> "Nor would these arrangements necessarily serve the interests of the improvident producers; they might merely permit more prudent competitors to escape refunds on concededly unlawful prices." (390 U.S. at 828, fn. omitted)

Subsequently, contrary to Respondents' arguments, consideration *and* correction of individual inequities have been characteristic of application of the area-rate method and Commission use of group procedures. Thus, the Commission decision for the Hugoton-Anadarko Area was tailor-made to apply *past* Commission policies and precedent equitably and to *remove* discrimination against Phillips Petroleum Company and other producers who had not previously settled their Section 4(e) refund liabilities. *Hugoton-Anadarko Area Rate Case: California* v. *Federal Power Commission*, 466 F.2d 974 (9th Cir. 1972).[5] Similarly, where the Commission had refused to apply its past policies and formulae equitably to individual producers, the Commission has been reversed. See *Mesa Petroleum Company* v. *Federal Power Commission*, 441 F.2d 182 (5th Cir. 1971); *Plaquemines Oil and Gas Company* v. *Federal Power Commission*, 450 F.2d 1334 (D.C. Cir. 1971).

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[5] The formula there applied was based upon the "composite" of past treatment of all other producers set forth in *Jack W. Grigsby*, 32 FPC 529 (1964). These data included the results of Mobil's settlements, as well as others. Contrary to arguments of Respondents here, Mobil urged the Commission to adopt and apply the *same* formula for equitable disposition of the refund issue in the instant case (IV A. 749-752, V A. 242e-247e).

It thus is plain that the area-rate method does not "require" the results reached in this case. Even if the "aggregate cost-aggregate revenue" approach indicated past industry revenue deficiences, such a conclusion could not justify the rate structure adopted. Such a conclusion would not, did not, and cannot require fashioning an area rate structure for the present and future solely to minimize refund liabilities of a small group of producers, as correctly held in the *Texas Gulf Coast* case.

Here, neither Mobil's compliance with past policy nor the area rate method created the unlawful results. The results were fashioned by the brokers of the "settlement" to accommodate a few producers. However, those who owe refunds should pay them or obtain equitable relief consistent with standards of Sections 4 and 5 of the Act. Retention of substantial amounts by a handful of producers does not justify (1) reduced exploration allowances and lower present and future area rates for "flowing gas" prescribed for *all* area producers (see II A. 647-648); (2) lower present and future "new gas" rates and lower realization on new gas sales for *all* producers (see II A. 870); (3) imposition of unsupported moratoria (see App. C to Pet., pp. 51-52); or (4) permitting some producers to receive unearned contingent escalations in "flowing gas" rates to be earned by Mobil and others by dedication of new reserves.

Correction of the errors does not involve undue delay, as Respondents argue. The record permits prompt, summary disposition of the refund issue by Commission decision consistent with Sections 4 and 5 of the Act and with the principles set out in the *Texas Gulf Coast* opinion. Valid area rates for the period from and after August 1, 1971 then can be prescribed without an attempt to spread the burdens of individual company refund liabilities over the entire Southern Louisiana producing industry.

III. Rates Prescribed for the Past and Future Are Not Based on Required Findings and Violate Standards of Sections 4 and 5 of the Natural Gas Act

Respondents erect retrospective justifications for the rates set out in the "settlement package," but there are no Commission findings and conclusions on critical issues, and standards of the Act were ignored:

A. *Rates for the Period Prior to Issuance of Opinion No. 598*

The "settlement" proposals contained detailed figures to compute refunds to arrive at a total liability of $150,000,000. Now, it is argued that various data upon which the Commission made *no* findings justify each of the rate figures and formula elements set out in the proposal.

A basic difficulty for Respondents is that the record contained "test-year" flowing gas cost studies for the years 1960 and 1969 only. Nevertheless, various graphs and tables are constructed to illustrate findings the Commission *might have made* (see, *e.g.*, Exxon Br., pp. 19, 26-27, Apps. A and B). Yet, the Commission opinions reflect no sources other than the provisions of the proposal and no rationale or reasons for the choices made:

(1) *Period prior to January 1, 1965.* The rates apparently were picked from past Section 7 settlement orders, not cost data now proffered (see California Co. Br., p. 9), and there is no valid rationale for the date selection;

(2) *Period from January 1, 1965 to October 1, 1968.* The rates apparently came from the Fourth Amendment to the Commission's Statement of General Policy No. 61-1 issued October 31, 1961, not January 1, 1965 (see 24 FPC 661), and not from "cost" data now proffered; and

(3) *Period from October 1, 1968 to January 1, 1971.* For this period, a formula for rate reduction is imposed

to make up a total of $150,000,000, but the formula is not derived from the proffered "cost" data, and was designed to protect and benefit a few producers who collected the highest rates during this period and to penalize other producers, such as Mobil, who collected lower rates during this period (see Mobil opening Brief, pp. 50-51, and Appendix A-2 to that Brief).[6]

For the entire period prior to effectiveness of Opinion No. 598 on August 1, 1971, two extremes are presented. Petitioner MDG asserts that refunds of all amounts collected in excess of rates found just and reasonable should be paid; but some Respondents argue that the Commission *could* have found *no* refunds were due for these past periods (*e.g.*, UDC Br., p. 32; Exxon, *et al.*, Br., pp. 26-27). However, the Commission actually canvassed neither proposition on the basis of record evidence and made no findings or conclusions of its own, even as to "aggregate cost-aggregate revenue" comparisons such as those rejected in *Permian* but now reasserted by Respondents here (see II A. 593, 628-629). Opinion No. 598 simply contains nothing on the subject other than the terms of the "settlement" proposal, and no reasoned analysis or resolution by the Commission of the questions raised by MDG, on the one hand, or by the present Respondents, on the other.

Moreover, assuming *arguendo* that evidence did support refund relief for producers owing the bulk of the refunds for periods prior to August 1, 1971, that proposition still

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[6] One of the strangest characteristics of the rate formula in the "settlement" is the erratic increase and decrease of rates over the time periods involved. Thus for "offshore" rates, the formula provides (II A. 652-653):

> Prior to January 1, 1965—19.625 cents per Mcf
> Jan. 1, 1965 to Oct. 1, 1968—20.250 cents per Mcf
> Oct. 1, 1968 to Jan. 1, 1971—17 to 18.5 cents per Mcf
> After January 1, 1971—21.375 cents per Mcf.

would not justify confusing either their liabilities, or their relief, with the area rates to be prescribed and effective on and after August 1, 1971 for all other area producers. Yet, that is the result here: (1) revenues collected by certain producers prior to August 1, 1971 would be retained by them; (2) *because* of that, allowances making up the "flowing gas" rates and "new gas" rates to be effective on and after August 1, 1971 would be reduced, regardless of impact on *other* producers; and (3) imposition of moratoria on future increases by all producers also are said to be justifiable because of the amounts so retained by the favored few producers.

None of the extrapolations, tables, graphs, or recreations of "findings" the Commission never made, can justify such results. Producers who have run afoul of Section 4 standards should bear their own burdens as to the past and permit the Commission to prescribe lawful area rates for the period after August 1, 1971 for all producers.

B. *"Flowing Gas" Rates Established August 1, 1971 by Opinion No. 598*

Much of what is said by Respondents shows that the "flowing gas" area rates are below the levels required by the record and the current supply situation (see Mobil opening Brief, pp. 63-68).

Contrary to Respondents' arguments, Opinion No. 598 shows that the Commission made *no* decisional findings or conclusions on critical, disputed issues in the costing process, no intermediate finding as to the required return allowance upon "flowing gas" investment, and no ultimate conclusions as to revenue requirements for "flowing gas" sales. What it did say was that it had allowed the favored producers working capital by the treatment of refunds (II A. 628-629), and it did express the ultimate conclusion that rates proposed in the "settlement" were "just and reasonable."

Respondents' arguments cannot bridge these yawning chasms. In fact, their briefs show that the "flowing gas" rates are too low and underscore the prejudice to Mobil and others resulting from the Commission's refusal to resolve disputed issues. Thus, UDC refers to 1969 costs showing a range of 22 to 30 cents per Mcf, and annual cost increases since 1969 of at least 5% per year (UDC Br., pp. 36-37). The extrapolations of Exxon, *et al.*, further show (1) that by substitution of a 15% return only and *without* resolving other contested issues, the Staff's *1969* cost exceeded 22 cents per Mcf (Exxon, *et al.*, Br., App. A); (2) that with a 13% return and substitution of then "current" DD&A and E&D costs only, the cost would be between 24.76 cents and 28.40 cents per Mcf (Exxon, *et al.*, Br., App. B); and (3) that inflation has exceeded 5% and now has reached 9.4% per year (Exxon, *et al.*, Br., p. 34, fn. 43).

The Commission and Respondents conceded the necessity for internal generation of funds from "flowing gas" revenues and recognized the necessity for increased investment of such funds in exploration and development. Yet, the Commission simply did not resolve the vital questions presented. A regulatory agency cannot conclude that a rate is "just and reasonable" when it has not resolved disputed issues and has not constructed the required yardsticks.

The "settlement" and benefits bestowed thereby upon a selected few producers cannot shield these errors. If the Commission's Opinion No. 598 were sustained, the opinion would fix and freeze "flowing gas" rates on the basis of defective 1969 "costs" up to October 1, 1976, with minimal interim escalations. The Commission would do this without even knowing whether there was a valid starting point. Discussions of required increased commitments to this area then would become largely irrelevant. No "targets" could be met when inadequate revenues, tied to obsolete past costs, obviously would severely limit

capital formation, reinvestment, and exploration and development activity.

Plainly, the preferential relief bestowed upon the producers who owe refunds for *past* sales was the basis for the "flowing gas" rates imposed for the present and future. Standards of the Act, principles of *Hope*, and admonitions of *Permian* were disregarded to the detriment of all other producers. What is here thus is but a brokered, invalid "end result."

C. *"New Gas" Rates Established August 1, 1971 by Opinion No. 598*

Much the same is true for Respondents' arguments as to "new gas" for which the Commission approved the 26 cents per Mcf rate, but effectively allowed those who owe refunds the equivalent of 27 cents per Mcf (see Mobil opning Brief, pp. 59-63). While the result is unlawful as to Mobil, the error also has significant impact upon interstate supply of natural gas and can well fix responsibility for the deteriorating supply situation.

As to the "new gas" rate, Respondents argue that cost studies *could* have supported the result, but again, the Commission did not complete the task of making valid comparisons of costs and of predicted revenues. Significantly, UDC concedes here that "some evidence" supported a higher level (UDC Br., p. 35), and UDC cites the cost conclusion of its own witness, which was 27.58 cents per Mcf on 1969 data (UDC Br., p. 24). This cost is close to the realization of 27 cents per Mcf designed by UDC for those who owe refunds, but is significantly higher than the 26 cents per Mcf UDC would allow Mobil and others similarly situated. Similarly, the Brief for Exxon, *et al.*, makes clear that the 26 cents per Mcf level was directly tied to the treatment of refunds due for the period *prior* to August 1, 1971, and the Exxon, *et al.*, Brief is understandably silent on questions of ade-

quacy of such a level after that date and over the 1971-1977 years UDC would impose this "new gas" rate (Exxon, *et al.*, Br., p. 50).

Respondents' briefs also show that this so-called "current" and "incentive" "new gas" rate already is a recognized failure. Thus, in other contexts, Respondents refer to escalating prices in the competing intrastate market and to devices the Commission has been required to construct to circumvent Opinion No. 598, to allow rates of 45 cents per Mcf "outside the area-rate framework," and to return to "case-by-case" review of producer applications because of the strait-jacket created by this "settlement" (see e.g., UDC Br., pp. 45-46, and references by the court below at App. C to Pet., pp. 52, 59). These efforts would require the Commission to return, full-circle, to the "case-by-case" approach which the Commission abandoned in 1960, and which the Commission advised this Court in *Permian* was an unworkable method of producer regulation and an impossible administrative burden. The recognized failure of the "incentive" rates embodied in the "settlement package" thus would place the Commission in the impossible position of attempting to adhere to its Opinion No. 598 for some purposes, but, at the same time, of attempting to improve interstate supply by stop-gap methods abandoned as unworkable fourteen years ago.

Back of all this lies the Commission's statement in this case in Opinion No. 598-A on September 9, 1971:

> "Furthermore, refunds as a part of that package represented a policy decision; if such a policy decision had not been made as it was, the price for new gas might well have been greatly higher." (II A. 870)

That "policy decision" actually was an erroneous approval of an unduly discriminatory and unduly preferential rate structure, as correctly held in the *Texas Gulf Coast* case.

On remand, the error can be corrected promptly on the present record by prescription of a "new gas" rate independently of disposition of the refund issue. Such a rate then may be effective for the period from January 10, 1971—the date the last moratorium was lifted—until such date as a new rate is prescribed by Commission decision on data more up-to-date than the 1969 "current" costs in the record in this case.

D. *Combination of Elements of the Rate Structure*

Some respondents argue that the constituent elements of the rate structure cannot be separately reviewed, and that the overall "end-result" must be accepted as lawful (*e.g.*, Exxon, *et al.*, Br., 15; Pipelines Br., pp. 3-4). Neither contention is valid. The most significant elements affecting producers and consumers alike thereby would be glossed over and immunized from judicial scrutiny. Such an approach therefore was properly rejected by the District of Columbia Circuit in the *Texas Gulf Coast* case, and the unequal, unlawful "triumvirate" of provisions in this case must be similarly examined and condemned.

Respondents' briefs actually show that the objectives of the "settlement" have not been met. Thus, the Pipelines assert their expectations were that the refund and "incentive" provisions would produce total new dedications of 45 trillion cubic feet of new reserves in this area, over a five-year span, and that "target levels" of 2 to 3 trillion cubic feet above historical levels were expected (Pipelines Br., p. 16). This has not happened. Historical levels of new dedications of 6 to 7 trillion cubic feet per year have not been met, and none of the "targets" described in Respondents' briefs has been met.[7]

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[7] Under the "settlement," newly dedicated reserves are to be reported by producers and then made public monthly by the Commission (II A. 676-677). The Commission's Form 334 "Control Sheet"

The supply situation has further deteriorated, as UDC's Brief amply reveals.

Respondents would have the Court ignore the reasons for these failures. Yet, a major reason is that "refund-forgiveness" has not provided the "incentive" that should have been made available by adequate area rates for all Southern Louisiana producers. The area rate method contemplated regulation beneficial to, and providing opportunity for, *all* producers in a given area, not the preferential channeling of revenues and "incentives" set out in the "settlement." A second reason is that the area rate method contemplated frequent Commission review and modification of rate ceilings on the basis of changing economic conditions and cost and supply data kept reasonably current. *Permian* thus did not approve a method by which a decision tied to 1969 cost data would freeze rates, with minimal escalations, to 1976 and 1977, some seven and eight years after such a past "test-year."[8] Both reasonable rates and adequate supplies thus are dependent upon such responsible functioning by the Commission, but Opinion No. 598 bars such responsible functioning despite Respondents' arguments.

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for Southern Louisiana reflects that as of January 1, 1974, a total of only 957,416,800 Mcf have been reported to discharge refunds, and only 640,915,800 Mcf have been reported toward earning contingent escalations. This total of 1.8 trillion cubic feet is thus far less than historical levels, far less than the "settlement" "target" of 9 trillion cubic feet for one year only, and far short of the "settlement" "target" of 22.5 trillion cubic feet for the two-and-one-half year "span" since August 1, 1971 (*Cf.* Pipelines Br., pp. 16-17).

[8] As pointed out in Mobil's opening brief (p. 70), the Commission has already found, on the basis of national cost data in the form presented in this case, that *as of 1971*, the national average "cost of finding and producing gas is in the range of 38-48¢ per Mcf, before production taxes . . .". *Belco Petroleum Company, et al.*, Opinion No. 659-A, July 20, 1973, 50 FPC (mimeo. ed., p. 32). With average "current costs" in these ranges, rates frozen at 26 cents per Mcf in Southern Louisiana cannot induce increased efforts.

Nevertheless, this situation can be remedied for Southern Louisiana *without* the "delays" and "disruptions" foretold by Respondents:

(a) Assuming *arguendo* that MDG and New York are in error as to Commission "power" to modify Opinion No. 546 retrospectively, the refund liabilities may be reconsidered by the Commission and lawfully disposed of promptly under the *Grigsby* formula, with a result similar to that affirmed in the *Hugoton-Anadarko Area Rate Case, supra*;

(b) On the present record, the Commission may complete the required findings and conclusions and promptly prescribe valid "flowing gas" and "new gas" rates to be effective as of January 10, 1971 (the date the last moratorium was lifted); and

(c) Such rates then would remain effective until superseded by Commission orders in "national" proceedings it has already initiated to collect current data and to modify "new gas" and "flowing gas" rates (see references in App. C to Pet., p. 7, fn. 3).

Permian contemplated such lawful, equitable, on-going Commission review and modification of area rates. The remand in the *Texas Gulf Coast* case contemplates and permits such corrective steps for that area; and only such a remand and corrective steps now can produce a lawful area rate structure for more than half the decade of 1970's for the Southern Louisiana Area—an area which Respondents concede is more critical to adequate supplies of natural gas.

Conversely, the natural gas shortage cannot be ameliorated by converting the area rate method into a vehicle for permitting required working capital for only a handful of producers and for deliberate creation of a rate structure concentrating "incentive," benefits, and advan-

tages in the hands of a few.[9] The "positive" results, now so assiduously sought by those Respondents affected by the natural gas shortage, can flow only from modification of the unlawful rate design and results imposed by the "settlement."

IV. The Moratoria Are Unsupportable and Are Unlawful

Some of the Respondents seek to defend the imposition of moratoria on access to Section 4, extending to October 1, 1976 for sales of "flowing gas" and to October 1, 1977 for sales of "new gas" (California Co. Br., p. 27; UDC Br., pp. 44-45). The defenses, however, are at odds with the record and the grounds for the holdings below:

1. Below, the Court of Appeals treated the moratoria as permissible because of the "relief" accorded to some producers by "refund forgiveness" and because of assumptions that other future relief might be available

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[9] In this respect, data as to bids on offshore Louisiana oil and gas leases, discussed at page 41 and listed in Appendix F to the Exxon, *et al.*, Brief, are not probative and are misleading. The leases cover both oil and gas "prospects," and Exxon, *et al.*, have not separated known "oil-prone" and known "gas-prone" areas. With "new oil" currently selling for six times the FPC-prescribed "new gas" price on a BTU equivalent basis, statistics as to bids on "oil prone" acreage and on mixed "oil" and "gas" prospects are not indicative of assessment of the "incentive" resulting from the prices expected for natural gas only. Moreover, the Commission has found that companies having refineries in the coastal areas seek such leases not only for oil supply for those refiners, but also in the expectation of using natural gas in their own refineries and petrochemical complexes on the Gulf Coast. See *Public Service Commission of New York* v. *Federal Power Commission (Chandeleur I)*, 436 F.2d 904 (D.C. Cir. 1970); and *Public Service Commission of New York* v. *Federal Power Commission (Chandeleur II)*, 463 F.2d 824 (D.C. Cir. 1972). Aside from these defects in the Exxon, *et al.* figures, the tabulations in Appendix F to the Exxon, *et al.*, Brief *do* show that Shell Oil Company and Chevron (referred to in this case as "Standard Oil Company of California" and the "California Company"), major beneficiaries of the refund-forgiveness formula in this case, consistently have been among the highest bidders in the oil and gas lease sales since November, 1971.

(see Mobil opening Brief, pp. 71-75). The threshold question, however, was whether the moratoria were supported and lawful at the time of imposition.

Permian laid down very clear prerequisites, but Respondents ignore them. No "substantial evidence" as to projected conditions from 1969 or 1971 to 1977 is cited, and the record contains none. No effort is made to suggest that the Commission made the required findings, and it is self-evident that the skimpy five lines on the subject in the Commission's opinion do *not* contain the findings contemplated by *Permian* and Section 4 of the Natural Gas Act (see II A. 651-652).

Significantly, Respondents' arguments do show that the record refutes any basis for findings of stable, unchanging costs projected from the 1969 "test-year" into the 1970's and into future years. Thus, UDC cites assumptions by the Commission's Staff that after 1969, costs had risen and would rise at a rate of at least 5% per year (UDC Br., pp. 37-38); and throughout that brief and others, Respondents show the massive increased capital requirements in the 1970's to cope with the deteriorating supply situation in a period of rising costs and of continued inflation.[10] Thus, neither the record, the opinions, logic, nor the interests of producers and consumers provide *any* support for freezing rates tied to 1969 costs for seven and eight years after that "test-year, particularly when the Commission has already found that *as of 1971*, the average national cost of finding and producing natural gas was in the range of 38-48 cents per Mcf, before production taxes.[11]

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[10] Exxon, *et al.*, show that experienced inflation has, in fact, far exceeded 5%, and that the most recent experienced rate is in excess of 9% (Exxon, *et al.*, Br., p. 34, fn. 43).

[11] *Belco Petroleum Company, et al.* (Opinion No. 659-A, July 20, 1973), 50 FPC—(mimeo. ed., p. 32).

The "alternative" grounds of affirmance supplied by the court below also do not render imposition of the moratoria lawful in this case. Obviously, "relief" by way of the retained refund amounts was made available, but such "relief" can be significant only to the selected, preferred beneficiaries of that part of the rate structure. Such "relief" is meaningless for Mobil and other producers having small or no refund liabilities.

At the same time, Respondents' suggestions that all other producers must resort to other procedures to seek relief *outside* of the area-rate framework offer no remedies for the bulk of sales already commenced under long-term contracts in this area. Thus, the "option" of relief under Order No. 455, cited below and by UDC here, is available only on a case-by-case basis and *only* as to wells commenced *after* April 6, 1972 (see UDC Br., p. 45). Similarly, the "emergency sales" procedures under Order No. 431 are available *only* as to short-term, new sales to provide limited emergency relief to pipelines in curtailment (see UDC Br., pp. 45-46); and the "alternative" of seeking exceptions on a contract-by contract basis actually is an invitation to destroy the area-rate method by inundation of the Commission with scores of adjudicatory hearings and a reversion to conditions existent prior to initiation of the area-rate method in 1960 (*cf.* UDC Br., p. 46).

These suggestions, and recent efforts by the Commission to avoid the strictures imposed by the UDC "settlement" for over half the 1970's decade, thus merely underscore the fact that imposition of these long moratoria was unsupportable and patent error in the first place. The "end result" of the long moratoria is to prevent the producer industry from collecting revenues to provide the required capital for an expanded and accelerated exploration and development program, described at length by UDC, and to supply the unsatisfied demand, described at

length by the Pipelines and others. Such capital is provided from revenues from sales under the long-term contracts already classified as "flowing gas" and "new gas" in this case. Therefore, it is *only* by periodic, timely Commission review and modification of the area rate structure during the 1970's that relief or attainment of current supply objectives can be achievable. Frantic efforts to devise "exceptions" or to pierce the barriers to Section 4 erected by the UDC "settlement" would never permit such Commission action or the desired results.

As Mobil has shown, a "workable" solution was a moratorium of no more than three years from the effective date of the Commission's opinion. As noted *supra*, the Commission has already made findings that costs *have* increased since 1969 and has instituted proceedings to collect more up-to-date data. Reversal as to the moratoria here thus will permit the Commission to proceed with its functions under Sections 4 and 5 of the Act for this vital supply area without the impediments imposed by the "settlement."

In sum, the moratoria have no valid basis in the record and violate the teaching of *Permian*; alternative grounds for affirmance supplied by the court below are not permissible; and the suggestions here that the area-rate framework should be dismantled by various "exceptions" show that the unsupported moratoria should not have been adopted in the first place.

2. Respondents' arguments raise an additional question as to the moratoria.

Respondents suggest that even if the moratoria were affirmed and Opinion No. 598 became final, the Commission apparently would be free to dissolve the moratoria and modify the area rates prescribed by Opinion No. 598 (see, *e.g.*, UDC Br., p. 46; California Co. Br., p. 27). Therein, however, lies the course to entrapment of sellers

of natural gas under existing long-term contracts in the Southern Louisiana Area.

The "settlement" agreement contains no provision for such general modifications prior to October 1, 1976 for "flowing gas" or prior to October 1, 1977 for "new gas" (see II A. 675-702); and Opinion No. 598 contains no express reservations or provisions for such a general lifting of the moratoria (see II A. 655-661). Therefore, if the opinion and underlying agreement were approved, affirmed, and final, arguments and issues such as those now raised here by MDG and New York would be certain to follow any such future action of general applicability prior to October 1, 1976 and October 1, 1977.[12] Questions such as those raised here as to Commission "power" to so modify an "affirmed" and "final" order then would follow under Section 19(b) of the Act, and further clouds and litigation over new Southern Louisiana area rates would be inevitable. An additional question would present itself: if the Commission should then so vitiate one part of the "package" settlement agreement, would the remaining terms then be automatically vitiated by operation of the provisions of the "agreement," or by further Commission action?

All of this can be avoided without such further generally-applicable litigation and without the alternative piece-meal destruction of the area-rate method suggested by Respondents. The invalid moratoria should be set aside now, and Southern Louisiana area rates should be left to further, timely, prospective modification by Com-

[12] Since the "agreement" and terms of Opinion No. 598 become parts of "rate schedules" under Section 4 of the Act, arguments over validity of "unilateral" changes of "agreements," such as those considered in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), also would be raised. Since Mobil has not joined in that "agreement," such an issue could not be raised as to Mobil, but existence of the question obviously can delay and undermine any generally-applicable relief that requires lifting of these moratoria on Southern Louisiana sales.

mission orders in proceedings it initiates under Sections 4 and 5 of the Act. Otherwise, lawful rates for the area are either precluded or placed in jeopardy for at least half of the present decade.

V. The Invalid Provisions for Transportation Charges to Be Collected by Pipelines Should Be Set Aside, and These Issues Should Be Remanded to the Commission

Respondents argue that the invalid mandatory minimum charges for transportation of liquids and liquefiable hydrocarbons should be left undisturbed (*e.g.*, Pipelines Br., pp. 19-22; UDC Br., pp. 43-44; California Co. Br., p. 28). Obviously, confusion, at the very least, exists because the Commission dealt with the same subject matter in two separate proceedings, and the last and superseding order has been reversed and remanded for further Commission consideration in *Mobil Oil Corporation* v. *Federal Power Commission*, 483 F.2d 1238 (D.C. Cir. 1973):

1. The sequence of Commission actions and status of the charges in this case require clarification. The status described in the Pipelines' Brief (pp. 20-21) is not correct.

As Mobil showed at pages 75-80 of Mobil's opening brief, these pipeline charges were outside the scope of the proceeding to fix producers' area rates until suddenly interjected by the filing of the UDC "settlement" proposal on November 6, 1971. The question of such charges already was at issue in the separate, general rulemaking Docket R-338, initiated February 5, 1968, which was applicable to all areas, including Southern Louisiana. While the present case proceeded to decision and review before the Fifth Circuit, the Commission, nevertheless, proceeded to deal with the same subject matter in that general rulemaking docket and issued its Order No. 449 therein on January 31, 1972.

That order prescribed generally-applicable regulations, and the Commission *expressly* made those regulations operative and controlling for the Southern Louisiana Area. Opinion No. 598 had indicated Docket No. R-338 would be terminated as to Southern Louisiana. However, the Commission reversed itself in Order No. 449 and stated:

> "The Commission has received Southern Louisiana contracts dated prior to August 1, 1971, proposing sales which have not yet been certificated. Consequently, if this proceeding were terminated as to the Southern Louisiana Area, transportation services which might be rendered under such contracts would not be subject to the charges herein imposed. As hereinafter explained, the Commission has now concluded that the same transportation charges originally announced in Opinion No. 598 are appropriate for all other producing areas. In view of the uniform rates to be imposed for all areas, the Commission finds that it is preferable to have the order herein issued remain applicable to Southern Louisiana so that no producer proposing to sell gas and have liquids or liquefiable hydrocarbons transported from acreage in Southern Louisiana shall escape coverage under the rule enunciated herein if the sale and transportation services are commenced pursuant to a contract dated prior to August 1, 1971, but certificated subsequent to the effective date of this order." (*Pipeline Costs Allocable to the Transportation of Liquids, Liquefiable Hydrocarbons, Etc., for Others, Docket No. R-338*, Order 449, 47 FPC 208, 210 (1972))

The regulation prescribed (47 FPC at 216) thus was applicable to all areas, *including* Southern Louisiana.[13]

[13] The Pipelines thus are in error in stating that the Commission "terminated" the general rulemaking docket as to Southern Louisiana, and that the general Order No. 449 did not apply to the Southern Louisiana area (Pipelines Br., p. 21). The texts of Order No. 449 and of the *Mobil* opinion show that the Commission did not take such action.

Consequently, all issues, including the jurisdictional issue, proceeded in the general Rule making Docket No. R-338 to reconsideration under Section 19(a) of the Act and then to judicial review under Section 19(b) of the Act in the *Mobil* case before the District of Columbia Circuit. There, Order No. 449 was set aside as to all areas, including Southern Louisiana, and the case was remanded for further Commission consideration, where it remains today under the final mandate of that Court of Appeals.

Because of pendency of the issues, including the question of jurisdiction, in the earlier and still pending general rulemaking Docket No. R-338, such questions were not presented in the instant case. The provisions of Opinion No. 598 were superseded in that docket by Order No. 449, and the jurisdictional questions thus were not presented to or decided by the Fifth Circuit in this case. Those questions were before another court in the superseding docket and now are once more before the Commission.

As a result of this sequence, the Commission itself superseded the provisions in Opinion No. 598 and now has before it the remanded case in the generally-applicable rulemaking docket, which still is controlling for Southern Louisiana. As a further result, the provisions for mandatory minimum charges in the opinion before this Court have been rendered as inoperative anachronism, putatively applicable to Southern Louisiana even as to functions over which the Commission has been held to have no jurisdiction.

For these reasons, Mobil has urged that these provisions should be remanded for further Commission consideration. Under the mandate of the District of Columbia Circuit, such reconsideration is required in the general rulemaking docket fully applicable to Southern Louisiana. If nothing else, the Commission then can clarify

the confused status of its own orders issued in separate dockets but addressed to the same subject matter.

2. Aside from the questions of the jurisdictional defects and the nullification of these provisions by Order No. 449 and its subsequent history, Respondents argue that the charges are supported in this case (*e.g.*, Pipeline Br., pp. 20-21). However, these claims are not supported by findings in Opinion No. 598 (see II A. 650-651) or by the record cited by Respondents.

The "studies" have never withstood the scrutiny of complete Commission findings. Moreover, no one, here or below, has ever sought to explain how the results can stand when the pipeline "costs" upon which the "studies" are based have been reduced and partially disallowed by Commission action in the pipeline rate dockets from which the claimed "costs" were copied (see cases cited at page 79, fn. 25, of Mobil's opening Brief). If the "costs" were not acceptable to the Commission to fix the pipelines' other charges under Section 4 of the Act, the "costs" are equally excessive and inoperative for fixing these charges by pipelines to producers for transportation service.

Contrary to the Pipelines' argument, the record also shows that a highly selective process was used to construct the "studies," omitting some older pipeline systems that would reduce the "cost" averages (see IV A. 650-652, 657-663). The record also shows that the "studies" are heavily weighted by inclusion of main-line compression costs incurred outside Southern Louisiana in transmission and distribution, but which are not incurred in rendering the transportation services for producers in Southern Louisiana (IV A. 653-657, 672-673, 754). Other defects are enumerated at pages 78-80 of Mobil's opening Brief.

It thus was inevitable that the Commission found "certain difficulty" in accepting the charges set out in the

"settlement" proposal (II A. 650-651). The implications are clear that such acceptance was tied to the inclusion of the proposed mandatory minimum charges in the "package" which the Commission was told it must accept in its entirety. In any event, adequate, required findings would have shown the proposed charges to be unsupported, and that "substantial evidence" does not support these mandatory minimum charges by the pipelines which were belatedly and erroneously interjected into a proceeding initiated and conducted to fix producers' area rates.

3. Certain Respondents suggest that when these minimum charges are set aside, producers somehow are certain to obtain reduced rates detrimental to pipelines' distribution company customers (see UDC Br., p. 44). This is not correct, as the opinion of the District of Columbia Circuit in the *Mobil* case amply shows.

As to the non-jurisdictional transportation of liquids, costs are allocated in pipeline rate cases between jurisdictional and non-jurisdictional services by the pipeline. Only those costs allocated to jurisdictional services are the proper predicate for the rates to be charged by the pipelines to their jurisdictional customers. Costs allocable to non-jurisdictional functions and activities, including transportation of commodities other than natural gas, are to be recovered by the pipelines from those for whom they perform the other activities. This is the dichotomy required under the Act, as indicated in the *Mobil* case, and it does not have the adverse impact indicated by the arguments of UDC.

As to the transportation of liquefiable hydrocarbons which are in a baseous phase, these charges are before the Commission in the remanded general rulemaking Docket No. R-338 case. There, valid minimum charges can be fixed on a proper record, or the Commission may conclude to review such charges as presented to it with applications under Section 7 of the Act. In either event,

the results indicated by UDC, such as circumvention of Commission review, do not follow.

The portion of Opinion No. 598 containing these mandatory minimum charges by pipelines was superseded by Commission action; charges for all areas have been remanded in the *Mobil* case for Commission reconsideration; and these superseded provisions of Opinion No. 598 now should be formally set aside.

CONCLUSION

For the foregoing reasons and those set forth in Mobil's opening Brief, the opinion and judgment of the Court of Appeals should be reversed; provisions of Commission Opinion Nos. 598 and 598-A should be modified on the specific grounds here set forth by Mobil; and this case should be remanded to the Commission for further consideration, modification of the opinions, and issuance of a lawful decision and orders under Section 4 and 5 of the Natural Gas Act.

Respectfully submitted,

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